

# **REPORT OF THE AUDITOR-GENERAL TO THE MEMBERS OF THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE RATLOU LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006**

## **1. AUDIT ASSIGNMENT**

The financial statements as set out on pages 1 to 11, for the year ended 30 June 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) and section 126 of the Municipal Finance Management Act (MFMA). These financial statements are the responsibility of the Municipal Manager. My responsibility is to express an opinion on these financial statements, based on the audit.

## **2. SCOPE**

The audit was conducted in accordance with the International Standards on Auditing read with General Notice 1512 of 2006, issued in Government Gazette no. 29326 of 27 October 2006. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

### **An audit includes:**

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements,
- assessing the accounting principles used and significant estimates made by management, and
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations, which came to my attention and are applicable to financial matters.

I believe that the audit provides a reasonable basis for my opinion.

## **3. BASIS OF ACCOUNTING**

The municipality's policy is to prepare the financial statements on the entity specific basis of accounting as described in paragraph 1 of the accounting policies to the financial statements.

## **4. QUALIFICATION**

### **4.1 Opening balances**

As reported in the prior year, a disclaimer of audit opinion was issued. During the year under review no adequate corrective measures were implemented by management on qualifications reported.

The opening balances in the financial statements do not agree to the closing balances as per the final financial statements in the prior year due to material adjustments amounting to R3 094 760.

## **4.2 Funds, trust funds and reserves**

- 4.2.1 No supporting documentation could be provided to support the contributions to trust funds during the current year amounting to R5 061 233, expenditure incurred in trust funds amounting to R556 750 and journals amounting to R2 193 743. No alternative procedures could be performed.
- 4.2.2 Trust funds and reserves amounting to R13 544 280 as disclosed in note 1,2 and note 3 to the financial statements could only be backed-up by cash and investments amounting to R5 384 543. Therefore, I could not verify cash resources for funds and reserves amounting to R8 159 737.
- 4.2.3 Trust funds with negative balances amounting to R871 879 existed.
- 4.2.4 Reserves were overstated by an amount of R790 003 due to assets purchased in prior years that were not redeemed.

As a result I could not verify funds and reserves with a balance of R790 003 and trust funds with a balance of R12 694 276 as disclosed in the financial statements.

## **4.3 Fixed assets**

- 4.3.1 An incomplete fixed asset register was presented for auditing, and no supporting documents could be provided for an asset count that was performed, therefore I could not verify if the count that was performed was updated in the fixed asset register and accounting records at year-end.
- 4.3.2 The following instances also occurred :
  - Fixed assets to the value of R511 553 in the general ledger did not appear in the fixed asset register.
  - Fixed assets to the value of R25 175 in the fixed asset register did not appear in the general ledger.
  - No supporting documentation could be provided to support capital expenditure during the year amounting to R4 351 541 and journals amounting to R1 499 468. No alternative procedures could be performed.
  - The assets additions list provided for audit purposes, differed by R4 987 165 from the additions amount per note 4 to the financial statements.
  - Capital charges of R8 053 413 as disclosed in the financial statements differed with the trial balance amount of R26 224 864 by R18 171 451.

As a result I could not verify the fixed asset balance amounting to R1 030 122 as disclosed in the financial statements.

#### **4.4 Long-term debtors and short term portion of long-term debtors**

The recoverability of long outstanding debtors amounting to R271 473 could not be established. These debtors were not included in the doubtful debt provision.

As a result, I could not verify long-term debtors and the short-term portion of long-term debtors amounting to R358 752 disclosed as part of debtors in the financial statements.

#### **4.5 Debtors**

4.5.1 Insufficient supporting documentation was provided for a debtor journal amounting to R1 223 691.

4.5.2 A debtor amounting to R609 519 was incorrectly raised for government grants from National Treasury resulting in an overstatement of debtors and revenue. This amount is not collectable.

As a result I could not verify debtors amounting to R4 927 861 as disclosed in the financial statements.

#### **4.6 Bank and cash**

4.6.1 I noted a difference of R330 714 between the main bank account balance in the general ledger and the bank reconciliation balance.

4.6.2 No monthly bank reconciliations were done, reviewed or approved by a senior official during the year and the reconciliations were only performed close to year-end.

As a result I could not verify bank and cash amounting to R1 161 378 as disclosed in the financial statements.

#### **4.7 Provisions**

I could not verify the leave provision as a result of incorrect leave days and basis amounts that were used for the calculation of the provision. The leave policy provisions were also not applied consistently.

As a result, I could not verify provisions amounting to R474 654 as disclosed in the financial statements.

#### **4.8 Creditors**

Creditors were understated by a net amount of R49 438 for the year under review due to inaccurate cut-off and monthly creditors reconciliations that were not performed, reviewed and approved.

As a result I could not verify the creditors amounting to R1 286 139 as disclosed in the financial statements.

#### **4.9 Value-added-tax (VAT)**

The following issues with regard to VAT were identified:

- The basis used to claim and accrue VAT was not consistently applied throughout the financial year as the municipality claims input VAT on a cash basis and the output VAT is claimed on an invoice basis.
- The monthly reconciliation between the VAT201 and the VAT control account in the general ledger was not performed.
- The VAT as per the financial statements differs with the VAT201 reconciliation by R1 750 108 as a result of unclaimed input VAT not yet submitted to SARS for refunding. The recoverability of this amount could not be established.

As a result I could not verify the VAT balance amounting to R5 664 414 as disclosed in the financial statements.

#### **4.10 Revenue**

4.10.1 Insufficient supporting documentation was provided for sundry income amounting to R 171 072.

4.10.2 Due to a lack of supporting documents in the form of signed lease agreements, lease income amounting to R105 060 could not be verified.

4.10.3 The completeness of rental income could not be verified as a result of a possible loss of income amounting to R60 541 due to escalation clauses in the rental agreements not being applied and collected from lessees.

4.10.4 The municipality rents out numerous houses to employees but no revenue was recorded and no debtors were raised during the year. No supporting documents in the form of rental agreements could be provided and therefore the extent of revenue losses could not be established.

As a result I could not verify revenue amounting to R1 158 259 as disclosed in the financial statements.

#### **4.11 Expenditure**

4.11.1 It was noted that an amount of R300 686 was classified as operating expenditure instead of employee costs because it represents an increase in the leave pay provision.

4.11.2 Expenditure could not be verified as correctly stated due to the fact that no supporting documentation could be provided for supplier payments amounting to R151 719 and journals amounting to R1 137 882. No alternative procedures could be performed.

As a result I could not verify general expenses amounting to R7 296 706 as disclosed in the financial statements.

#### **4.12 Employee cost**

- 4.12.1 No supporting documents could be provided for the wage tariffs used during the year and therefore wages amounting to R651 228 could not be verified.
- 4.12.2 Leave encashment amounting to R163 382 could not be verified mainly due to the fact that the basis of calculation and the days and tariffs used are incorrect and do not comply with SALGA HRD Circular 26 of 2003.

#### **4.13 Contingent liabilities**

- 4.13.1 Contingent liabilities comprising legal claims against the municipality amounting to R 2 204 084 were not disclosed as required by the Institution for Municipal Finance Officers (IMFO) guidelines.
- 4.13.2 Retirement benefits were not disclosed and no supporting documents could be provided to determine the type of fund and the value of fund assets and liabilities. I was therefore not able to determine the position of the pension fund and any possible liability on the part of the municipality.

#### **4.14 Capital commitments**

- 4.14.1 No supporting documents could be provided for capital commitments amounting to R2 150 000 and council resolutions for capital projects amounting to R24 820 000.
- 4.14.2 Capital projects amounting to R9 447 534 were identified that were not included in the capital commitments note to the financial statements.

As a result, I could not verify capital commitments amounting to R24 820 000 as disclosed in the financial statements.

### **5. DISCLAIMER OF AUDIT OPINION**

Because of the significance of the matters in the preceding paragraph, I do not express an opinion on the financial statements.

### **6. EMPHASIS OF MATTER**

Without further qualifying the audit opinion, attention is drawn to the following matters:

#### **6.1. Financial statement disclosures**

The financial statements of the municipality do not comply, in all respects, with the disclosure requirements as required by IMFO and the MFMA:

- The amount of R10 830 110 reflected for debtors on the balance sheet does not agree to the amount of R10 471 358 (Note 8). The variance is an amount of

R358 752 which according to Note 7 is the short-term portion of long-term debtors included in debtors.

- The amount reflected on the face of the balance sheet for bank and cash is R1 161 378, whereas the amount reflected on the cash flow statement is R1 929 096. This leads to a variance of R767 718.
- The amount of R26 101 347 (Investment in Fixed Assets) does not tie back to the amount of R26 414 014 reflected in Appendix B. This results in a variance of R339 667.
- The amount of R24 224 799 (Capital Expenditure) reflected in the 2004 column of the Treasurers Report, does not agree to the amount of R29 598 144 reflected in Appendix B. This leads to a variance of R5 373 345. Furthermore, the prior year indicated in Appendix B is 2003/2004 instead of 2004/2005.
- The amount of R12 981 316 (capital out of income) does not agree to the amount of R7 913 504 reflected in Appendix B. There is a discrepancy of R5 067 812.
- Material differences were identified between the financial statements and trial balance, Appendix B and note 4 to the financial statements and Appendix B and the treasurer's report.
- An amount reflected in Note 16: Cash generated by operations does not agree to the amount reflected in Appendix D. There is a discrepancy of R18 191 451.
- Included in basic salaries is an amount of R1 294 293, which relates to basic allowances for councillors and leave encashment amounting to R163 382. This amount must be disclosed separately as councillors' allowances in the income statement as required by section 124 of the MFMA.
- Capital commitments as disclosed in Note 22 to the financial statements do not comply with the IMFO disclosure guidelines.

#### **6.2.1 Non-compliance with laws and regulations**

The following instances of non-compliance with the MFMA occurred:

- Section 79 – Delegations of authority were not done according to the requirements of the act.
- Section 95 (c)(i) – No risk management policy was developed and no risk assessment was conducted.
- Section 13(1) - No cash management, investment and trust and statutory funds policies existed.
- Section 71(1) – The budget report was not done in the prescribed format and also not at the end of each month.
- Section 65(2)(e) – Creditors were not paid within 30 days.

#### **6.3 Internal control and other matters**

The council did not have the following internal control measures in place:

- Asset management policy
- Segregation of duties within procurement and cashier environment
- Cash management policy, safeguarding of assets and access control to assets
- An investment policy was developed but not implemented
- Fraud prevention plan

- Corporate governance policy
- Inventory management policy
- Credit control and debt collection policy not applied
- Revenue management policy
- Formal job descriptions and delegation of authority
- Vacant posts of key officials not filled
- Environmental impact policy

#### **6.4 Human resources**

The following matters were identified during the audit of human resources and the payroll:

- 6.4.1 Insufficient or no employment contracts and appointment letters for section 57 employees and other employees were identified and the contracts that were provided were not sufficient mainly as a result of no description of duties and responsibilities, no authorising signature of the council, lack of annual and sick leave entitlements and no mention of any Human Resources Policy and Conditions of Basic employment.
- 6.4.2 There was no documentation on certain employee files authorising payroll deductions from employees.
- 6.4.3 Some employee contracts and employee files did not contain information regarding the amount of allowances and benefits that the employees were entitled to.
- 6.4.4 No approval existed for some employees regarding their remuneration packages on appointment, and no mention thereof was made in the employment contracts.
- 6.4.5 Various employment contracts were signed by the municipality only after the commencement date of services by the respective employees.
- 6.4.6 The bank does not send back a confirmation to the municipality regarding the EFT payments for salaries.
- 6.4.7 A wages register and employee files were not kept for wage employees and no payroll run was performed, reviewed and approved.
- 6.4.8 A physical verification of employees could not be done due to the fact that there were no copies of identity documents in the employee files against which information could be verified.
- 6.4.9 No breakdown could be provided of the vote number in the general ledger to which salaries were allocated, which constitutes a lack of audit trail.
- 6.4.10 Several significant discrepancies were identified during the audit of sick leave, unpaid, annual and other leave mainly as a result of improper application of a leave policy, insufficient control and approval for leave and inaccurate accounting of leave.

- 6.4.11 Certain employees did not take the minimum compulsory leave days as required by section 7(2) of the SALBC agreement nor did they comply with the maximum leave days to be accrued as required by section 7(3) and (4) of SALBC.
- 6.4.12 It was determined that none of the overtime worked by employees in the period under review had been approved and discrepancies were identified when comparing the overtime per the time sheets against the payroll system. Inaccurate calculation of overtime was also identified due to incorrect hours and rates used.
- 6.4.13 The employee hours of overtime worked per month do not comply with the requirements of Section 10(1)(b) of the Basic Conditions of Employment.

## **6.5 Internal Audit**

- 6.5.1 Although an Audit Committee has been formed, it has not functioned efficiently during the current financial year. An audit committee plays a role through helping to ensure high quality financial reporting as well as effective internal control. It also provides an important focus for discussions with the internal auditors of the council.
- 6.5.2 No risk assessment was performed by internal audit to identify areas to perform internal audit procedures on. Limited work has been performed by internal audit shared services.

## **6.6 CIS environment**

During the review of the CIS environment the following weaknesses were identified:

- IT crucial services have not operated for the entire period, which will affect the service delivery of the municipality.
- There are no IT administration policies.
- No control over security breaches existed and log files were not reviewed or retained
- Inadequate review of access rights
- No firewall has been implemented
- No reviews were made to detect illegal or unauthorised software
- No formalised DRP existed and copies were not kept off-site
- No configuration management system
- No incident response procedures
- No MSP / IT strategy
- Inadequate virus protection

## **6.7 Supplementary information**



The supplementary schedules set out on pages 12 to 16 do not form part of the audited financial statements and are presented as additional information. These schedules have not been audited and accordingly no opinion is expressed thereon.

## **7. APPRECIATION**

The assistance rendered by the staff of the Ratlou Local Municipality during the audit is sincerely appreciated.



ME Ntshiea *for* Auditor-General

Rustenburg

30/11/2006



A U D I T O R - G E N E R A L